

IN THE

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**Supreme Court of the United States** DAVIS, CLERK

OCTOBER TERM, 1963

**J. I. CASE COMPANY, HARRY G. BARR, JOHN T. BROWN,  
L. R. CLAUSEN, WM. J. GREDE, E. P. HAMILTON, WM. B.  
PETERS, and MARC B. ROJTMAN,**

*Petitioners,*

vs.

**CARL H. BORAK, for and on behalf of himself and all of the  
other common stockholders of J. I. Case Company who are  
similarly situated to him,**

*Respondent.*

**PETITION FOR A WRIT OF CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS  
FOR THE SEVENTH CIRCUIT**

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*Respondent.*

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FOR THE SEVENTH CIRCUIT**

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*To the Justices of the Supreme Court of the United States:*

J.I. Case Company, Harry G. Barr, John T. Brown, L.R. Clausen, Wm. J. Grede, E.P. Hamilton, Wm. B. Peters and Marc B. Rojtmán, Petitioners herein, respectfully petition for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit, entered on May 29, 1963, reversing the District Court's Order of October 1, 1962, which dismissed Respondent's Third Amended and Supplemental Complaint for failure



to post security for expenses in accordance with Sec. 180.405(4), Wis. Stats. 1961, as previously ordered by the trial court.

### **Opinions Below**

The opinion of the District Court for the Eastern District of Wisconsin is not reported, although it is set forth in full in the Record herein at pp. 27-41. The opinion of the Court of Appeals for the Seventh Circuit is reported at 317 F(2d) 838.

### **Jurisdiction**

The judgment of the Court of Appeals for the Seventh Circuit was made and entered on May 29, 1963, and a copy thereof is appended to this petition in the Appendix at pp. 15-35. The jurisdiction of this Court is invoked pursuant to 28 USC § 1254 (1).

### **Questions Presented**

The question presented here, which has received diametrically opposing decisions in the United States Court of Appeals for the Second and Sixth Circuits (from that rendered here by the Seventh), involves an important matter arising under the Securities Exchange Act of 1934, 15 USC § 78a *et seq.* (hereinafter, the "Act") having nationwide effect on corporate action carried out through the use of allegedly misleading proxy statements filed with the Securities and Exchange Commission. The question is:

Whether Sec. 27 of the Act grants a Federal cause of action for rescission or damages to a corporate stockholder in respect of a consummated merger which was authorized pursuant to the use of a proxy statement alleged to have contained misleading statements violative of § 14(a) of the Act.

### Proceedings Below

This action grows out of the 1956 merger of American Tractor Corporation ("ATC") into J. I. Case Company ("Case"). In the Third Amended and Supplemental Complaint, which is the one before this Court, a stockholder on his own behalf and on behalf of others similarly situated attempts to state two causes of action.

COUNT I claims jurisdiction by reason of diversity of citizenship, 28 USC § 1332, and alleges fraud, mismanagement and self-dealing by the then Case directors and others, and asks judgment in favor of the plaintiff and those similarly situated and against such of Case directors and others as the Court may find responsible for the merger, for damages caused by an alleged deprivation of preemptive rights, or a decree directing defendant Case to issue securities to the plaintiff and those similarly situated to compensate them for the alleged loss of such rights.

COUNT II claims jurisdiction by reason of diversity of citizenship, 28 USC § 1332, the Securities Exchange Act, 15 USC § 78 aa, controversy arising under the laws of the United States, 28 USC § 1331, and the involvement of federal laws regulating commerce, 28 USC § 1337. It alleges violations of Sections 10(b) and 14(a) of the Securities Exchange Act of 1934 (hereinafter the "Act") and Rules promulgated thereunder and seeks judgment declaring the proxies solicited to be illegal and void, the merger void and/or damages for such alleged violations.

The District Court granted defendants' motion for security for expenses pursuant to Sec. 180.405(4), Wis. Stats., 1961, on the grounds that:

As to Count I, the plaintiff had unsuccessfully amended his Complaint to change the gravamen of

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the cause from a derivative action to a primary cause of action against the Company as well as its directors; and

As to Count II, the plaintiff had set forth a derivative action and despite the references to violations of federal law the gravamen of the cause was ruled by state law and the state security for expense statute was applicable.

On plaintiff's failure to post security the court entered an order striking the complaint and directed plaintiff to file a fourth amended and supplemental complaint limited to seeking a declaratory judgment as to whether or not proxies solicited in respect to the merger were void under Sec. 14(a) and the merger was void under Sec. 29(b) of the Act.

On appeal by plaintiff the Circuit Court of Appeals reversed the District Court and held that Count I set forth a primary cause of action against the Company rather than derivative on behalf of the Company and that Count II stated a cause of action arising under federal law to which the state security for expense statute did not apply and that the District Court could award damages or other retrospective relief thereunder.

#### **Statutes, Federal Rules, and Regulations Involved**

The pertinent portions of the Securities Exchange Act, 15 U.S.C., § 78a, *et seq.*, and Rule 14(a), 17 CFR 240.14a, are set forth in the Appendix at pp. 36-43.

## STATEMENT

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On October 15, 1956, after previous conferences and filing with the Securities and Exchange Commission, Case issued to its stockholders a proxy statement containing a notice of a special meeting of the stockholders to be held on November 15, 1956, for the purpose of approving or disapproving a plan whereby ATC would merge into Case.

On November 13, 1956, plaintiff filed his original action, naming Case and your petitioners herein, except Hamilton and Rojzman, defendants.<sup>1</sup> At the same time he obtained an order to show cause, returnable the following day, why Case, its officers, agents and employees should not be temporarily enjoined from taking any steps to advance the plan of merger described in the complaint. A hearing on the order to show cause was held on November 14, 1956, and the application for temporary injunction was denied on November 15, 1956. No appeal was taken from such denial.

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<sup>1</sup> Barr, Brown, Clausen, Grede, Hamilton and Peters were directors of Case at that time. Hamilton, while not an original defendant, was added as a defendant upon the filing of the First Amended and Supplemental Complaint, April 1, 1958, as were Rojzman, Elliott, Kraus, Ewing, Sturgis and Choate. Of these latter, Rojzman was the president and a director of ATC and became an officer and director of Case after the merger was consummated on January 10, 1957. Elliott and Kraus were directors of ATC and became directors of Case after the merger. Ewing, Sturgis and Choate were directors of Case prior to the merger and continued as such after the merger. Elliott, Kraus, Ewing, Sturgis and Choate have all filed special appearances and challenged the claimed personal jurisdiction over them. These motions have never been decided by the District Court, and accordingly these defendants have not joined in this Petition.

On November 15, 1956, the plan of merger was approved by 91.8% of the common shares represented at the meeting, voting as a class,<sup>2</sup> being 70.37% of total issued and outstanding common shares, and considerably in excess of the two-thirds majority required under Wisconsin law to approve a merger. The merger was consummated on January 10, 1957.

Following extensive and protracted discovery proceedings initiated by plaintiff, an amended and supplemental complaint was filed on April 1, 1958, adding 29 additional defendants. On October 23, 1958, the trial court ordered plaintiff to post security for expenses or join 3% of the Case common stockholders as plaintiffs pursuant to Wisconsin statutes. The plaintiff did not comply with this order of the court and the action was dismissed as to all defendants (R. 554-560).

The plaintiff commenced, but did not perfect, an appeal of this dismissal. Instead, he sought and was granted leave to file a second amended and supplemental complaint. Later he again sought and was granted leave to file a third amended and supplemental complaint.

The plaintiff in Count I of this third amended and supplemental complaint, in the District Court's words, "... has grasped at the exception stated in the court's oral opinion of October 13, 1958 ... has alleged the same facts which the court previously held asserted a derivative cause of action (making the security for expense statute applicable), garnished those facts with conclusory allega-

<sup>2</sup> In addition, 98% of the 7% Cumulative Preferred Stockholders of Case represented at the meeting approved the merger, this being 79.0% of the total issued and outstanding shares of such stock, and also well in excess of the % majority required by class voting under Wisconsin law.



tions that pre-emptive rights have been violated . . ." The Court of Appeals without respecting the District Court's finding that it was a ruse and a guise, reversed and from its "impression of the complaint as a whole" elevated the "garnished" and "conclusory allegations" to constitute the gravamen of the cause of action and thus held such Count stated a primary cause of action to which the state security statute is not applicable. In reaching this extraordinary result the Court of Appeals was obliged to create a situation where a stockholder is both suing his corporation and at the same time suing on its behalf.

Count II of the third amended and supplemental complaint claimed a violation of Secs. 10(b) and 14(a) of the Securities and Exchange Act which pursuant to Sec. 29(b) of that Act voided the merger. The District Court held that the allegations as to violations of Sec. 10(b) were surplusage and inconsistent with the facts alleged, and the Court of Appeals concurred. The District Court, in addition, held that it would follow the precedent of *Dann v. Studebaker-Packard Corp.*, 288 F(2d) 201 (CA 6th, 1961) and exercise its jurisdiction only to declare the proxies solicited pursuant to federal law valid or invalid; that it had jurisdiction by reason of diversity to give all the relief plaintiff sought, but that such relief was determinable under State law and not by federal statute and accordingly the state security for expense statute was applicable to Count II.

The Court of Appeals, as to Count II held a cause could be and had been stated for violation of Sec. 14(a) of the Act. It reversed the District Court as to its adherence to the *Dann* decision in principle and specifically refused



to follow it. The Court of Appeals held that the entire cause of action in Count II was created by federal statute, that retrospective relief could be given under federal law and that the state security for expense statute could not be appended to the enforcement of such federal right.

### **Reasons for Granting the Writ**

The decision of the Circuit Court of Appeals for the Seventh Circuit should be reviewed, as it reaches two important conclusions with respect to private actions brought under the Securities and Exchange Act, both in conflict with decisions in other circuits. Neither conclusion has been decided by this Court, but both should be.

#### **1. THERE IS A DIRECT CONFLICT OF DECISIONS BETWEEN THE COURT OF APPEALS FOR THE SECOND CIRCUIT, ON THE ONE HAND, AND THE COURTS OF APPEALS FOR THE SIXTH AND SEVENTH CIRCUITS ON THE OTHER.**

Count II of the Third Amended and Supplemental Complaint attempts to state a cause of action on behalf of the corporation, J. I. Case Company, derivatively brought by one of its stockholders, seeking retrospective relief to declare stockholders' approval void, rescind a consummated merger and/or collect damages from its directors and others under Sec. 29(b) of the Act. Consistent with the holding in *Dann v. Studebaker-Packard Corp.*, 288 F(2d) 201 (CA 6th, 1961), the court below held that plaintiff could maintain an action of this purport in direct contrast to the opposite conclusion also reached in *Howard v. Furst*, 238 F(2d) 790 (CA 2nd, 1956), *Cert. den.* 353 U.S. 937, 77 S. Ct. 814 (1957):

It will be noted at the outset that a fundamental difference in basic approach accounts for these diametrically opposed decisions in the Circuits. In *Howard v. Furst*, *supra*, it was pointed out that the Securities Exchange Act is a comprehensive, carefully drafted piece of legislation; that express provisions for private suits were set forth in §§ 9(e), 16(b) and 18. A specific statute of limitations was also set forth for such actions and a general provision voiding contracts made in violation of the Act was added in § 29(b). (See, Loss, *Securities Regulation* (2d Ed.), p. 1746) Looking to the legislative history of the Act, the Court for the Second Circuit found no support for the maintenance of a private action. See, Ruder, *Civil Liability Under Rule 10(b)(5): Judicial Revision of Legislative Intent?*, 57 NW LR 627 (Jan.-Feb., 1963). The Court then proceeded to apply the maxim of *expressio unius exclusio alterius* and by analogy to *Lauritzen v. Larsen*, 345 U.S. 571, 73 S.Ct. 921 (1953), held that ambiguous and equivocal language was insufficient to support an innovation in the law of such far-reaching results.

On the other hand, *Dann* and the court below in the instant case found that where a federal statutory duty is alleged to have been breached, a cause of action normally arises on behalf of the injured persons for whose benefit the statute was enacted. This conclusion is buttressed by citation of this Court's language in *Bell v. Hood*, 327 U.S. 678, 66 S.Ct. 773 (1946), and analogy to decisions which have sustained such an implied cause of action for alleged violation of Sec. 10(b) of the Act, such as *Fischman v. Raytheon Mfg. Co.*, 188 F(2d) 783 (CA 2d, 1951). See, Loss, *ibid*, *supra*, p. 1763.

The logical rules of statutory construction usually applied inescapably support the decision of *Howard v. Furst*, *supra*, because (a) all legislative history indicates no such private rights were intended in this particular instance; (b) the Act itself and the rules and regulations issued pursuant thereto provide in detail a procedure for submission and review of proxy statements by the Commission, and the Commission is clearly given the right to obtain judicial sanction to uphold its decisions in this regard (See, H.R. Rep. No. 1383, 73rd Cong., 2d Sess. (1934) pp. 13-14); (c) while the analogy to *Bell v Hood* and the Sec. 10(b)(5) decisions may be consistent because that section refers to rights for fraud and deceit "upon any person," Sec. 14(a) and its philosophy were included specifically for the purpose of furnishing information "essential to the intelligent exercise of his right of franchise"—(10 SEC Ann. Rep. 51 (1944))—that is, the mandate of the statute is aimed at a public purpose to be enforced by a created agency of government as opposed to the mandate of Sec. 10(b) which deals with direct frauds upon individuals.

Moreover, the cause of action for violation of § 14a of the Act, created by the Court of Appeals for the Seventh Circuit's construction of § 27 of the Act, imposes an unnecessary and unintended hardship upon corporations and their shareholders. Not only is there no reason to believe that Congress intended to allow a shareholder to challenge major corporate transactions after the fact in a new type of federal proceeding, but it is unnecessary for the courts to create such a new type federal proceeding. As Judge Dimock pointed out in *Lapchak v. Barium Steel Corp.*, CCH Fed. Sec. L. Rep., Par. 90,721 (S.D.N.Y., 1955), the gravamen of a shareholder's claim for retrospective relief, even when an allegedly misleading proxy statement is involved, must in essence rest upon state law:

"Even plaintiffs concede that if the proxy statement were followed by a fair exchange the directors would not be liable to the corporation. Also, it is clear that, had the proxy statement been perfectly lawful but followed by an unfair exchange, the directors would be liable for damage sustained and profits realized in violation of their fiduciary duties."

"... Since the liability asserted by plaintiffs may be proved without regard to the proxy statements and cannot be proved without regard to the alleged breach of fiduciary duty it is impossible to say that plaintiffs are asserting a right under or created by a federal law. The allegations as to the proxy statement are either mere surplusage or a mere pretext for assertion of federal jurisdiction."

## **2. THERE IS A DIRECT CONFLICT OF DECISIONS BETWEEN THE COURT OF APPEALS FOR SIXTH AND SEVENTH CIRCUITS.**

If it is determined that, absent a supporting legislative history and clear and unambiguous statutory authority, Congress did intend or the federal courts will recognize a private action for alleged violations of Sec. 14(a) of the Act, it then becomes important to determine the limitations, if any, upon the relief available under the Act. Again there is a direct conflict in the circuits. In *Dann, supra*, the Sixth Circuit held that relief would be limited to a declaratory judgment as to the validity or invalidity of the proxies solicited pursuant to Sec. 14(a) and that retrospective relief in the form of rescission and damages was dependent upon the application of state law, which it would not apply in that case because of a lack of diversity of citizenship.

In the instant case, the District Court followed *Dann* in principle, but, since diversity of citizenship was present, held the court had jurisdiction to grant any relief to which the plaintiff could show he was entitled. It was specifically held; however, that the relief of rescission and damages was so interrelated with the organic law of the corporation that the main thrust of the action was derivative under state law and the Wisconsin security for expenses statute was applicable.

The Seventh Circuit Court of Appeals, in reversing the trial court, specifically disagreed with the Sixth Circuit's rationale in *Dann*. It stated that the Sixth Circuit had failed to correctly distinguish *Gully v. First National Bank*, 299 U.S. 109, 57 S.Ct. 96 (1930) in its application. The Seventh Circuit held that *Gully* involved a federal statute only collaterally, whereas in *Dann* and the instant case the "whole right of action" is derived from the federal statute.

Petitioners submit that this is an erroneous distinction, for plaintiff's claim under Count II in the instant case cannot be adjudicated without reference to and reliance upon the Wisconsin statutory law and the organic law of the corporation. In this regard, the language of *Howard v. Furst, supra*, at p. 79, is particularly in point:

"Applying this test it is clear to us that every essential element of appellant's case depends upon the common law and the statutes of the State of New York. If the individual defendants who controlled 60.68% of Circle's outstanding stock, in violation of their fiduciary duties as directors and officers of Circle, brought about a sale of Circle's assets for a grossly inadequate sum, all in furtherance of their personal and private interests, the case would be ripe



for judgment for rescission of the sale or for damages, wholly irrespective of whether some or all of the individual defendants had participated in the formulation and sending out of a false or misleading proxy statement. The allegations with reference to the proxy statement constitute a mere excrescence or superfluity tacked onto what are otherwise sufficient allegations of a claim for relief under New York law.

"The controversy as to the interpretation to be given Section 14(a) is, therefore, not basic but collateral to appellant's case."

The Seventh Circuit's second claim of distinction is that *Dann* failed to distinguish between a question of jurisdiction and the merits of the case. The substance of this assertion does not appear clear from the balance of the opinion, for the court below then proceeded to state that Sec. 27 has often been held to provide private remedies for violations of Sec. 10(b), a conclusion to which no one takes exception.

### **3. THE QUESTIONS PRESENTED ARE IMPORTANT AND CONFLICTS SHOULD BE RESOLVED BY THIS COURT.**

The questions presented by this case are of great and recurring significance, both to individual stockholders, the investing public, corporate officers and directors, and the Securities and Exchange Commission, which asked and was granted leave to appear *amicus curiae* in the Court of Appeals. The important nature of these issues as to individual rights under the Securities Exchange Act and the breadth of the judicial function and power make this case peculiarly appropriate for the exercise of this Court's discretionary jurisdiction. There is plain conflict among three circuits.



**CONCLUSION:**

For the reasons set forth above, it is respectfully submitted that this petition for a Writ of Certiorari should be granted.

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**APPENDIX**

**Opinion of the Circuit Court of Appeals for the  
Seventh Circuit, dated May 29, 1963**

**In the**

**United States Court of Appeals  
For the Seventh Circuit**

**No. 13947      SEPTEMBER TERM, 1962      APRIL SESSION, 1963**

Carl H. Borak, for and on behalf of  
himself and all of the other common  
stockholders of J. I. Case Company  
who are similarly situated to him,  
*Plaintiff-Appellant,*

**v.**

J. I. Case Company, a Wisconsin corporation, Marc B. Rojzman, individually and as representative of all American Tractor Corporation shareholders who received J. I. Case Company common and second preferred stock in the merger herein referred to, and their successors in interest, John B. Elliott, Executor of the Estate of Edward L. Elliott, deceased, A. O. Choate, William Ewing, L. R. Clausen, H. S. Sturgis, John T. Brown, H. G. Barr, William J. Grede, E. P. Hamilton, William B. Peters, Mentor Kraus, and Nathaniel C. Beeber, individually and as representative of all holders of common stock purchase warrants issued by American Tractor Corporation to the purchasers of its preferred stock, Series 56-1,  
*Defendants-Appellees.*

On Appeal from  
the United  
States District  
Court for the  
Eastern District  
of Wisconsin.

**May 29, 1963**

Before DUFFY and KILEY, *Circuit Judges*, and MERCER, *District Judge*.

MERCER, *District Judge*, Plaintiff, Carl H. Borak, the holder of 2,000 common shares of J. I. Case Company, hereinafter referred to as Case, commenced this suit below on November 13, 1966, by filing his complaint in which he sought to have the then proposed plan of merger between Case and American Tractor Corporation, hereinafter ATC, declared illegal and void and to have Case and its officers and directors enjoined from taking any action to consummate the plan. Injunctive relief was denied. Subsequently plaintiff has filed three amended and supplemental complaints, the third of which was filed on January 12, 1962. It is that complaint which gives rise to this appeal. That complaint is in two counts, the first of which is based upon the laws of the state of Wisconsin and invokes the court's jurisdiction on the basis of diversity of citizenship. The second count purported to allege violations of Section 10(b) and 14(a) of the Securities Exchange Act of 1934, 15 U. S. C. A. 78j(b), 78n(a), and the jurisdiction of the court over that count is asserted to exist by reason of the provisions of Section 1331 and Section 1337 of the Judicial Code, 28 U. S. C. A. 1331, 1337, and Section 27 of the Securities Exchange Act. 15 U. S. C. A. 78aa.<sup>1</sup>

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<sup>1</sup> "The district courts shall have original jurisdiction of all civil actions wherein the matter in controversy exceeds the sum, or value of \$10,000, exclusive of interest and costs, and arises under the Constitution, laws or treaties of the United States." 28 U. S. C. A. 1331(a).

"The district courts shall have original jurisdiction of any civil action or proceeding arising under any Act of Congress regulating commerce or protecting trade and commerce against restraints and monopolies." 28 U. S. C. A. 1337.

"The district courts of the United States \* \* \* shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. \* \* \*" 15 U. S. C. A. 78aa.

After the third amended complaint was filed, the defendant<sup>2</sup> filed a motion for an order to compel plaintiff to provide security for expenses incurred and to be incurred by the defendants in defending the suit to comply with the provisions of Wis. Stat. § 180.405(4).<sup>3</sup> After a hearing upon that motion the court filed an opinion holding that the only cause of action stated in count 1 of the complaint was derivative in nature and that the Wisconsin security for expense statute applied thereto, that count 2 does not state a cause of action under Section 10b of the Act,<sup>4</sup> that

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<sup>2</sup> The identity of persons who have from time to time been named defendants in this suit has varied in the several amended complaints. Since the precise identity of the persons who are defendants has no particular bearing upon the issues presented on this appeal, the term "defendants", when used in this opinion, is a reference to all persons who were so named at any particular stage of the proceedings below as the context may require.

<sup>3</sup> "In any action brought in the right of any foreign or domestic corporation by the holder or holders of less than 3 per cent of any class of shares issued and outstanding, the defendants shall be entitled on application to the court to require the plaintiff or plaintiffs to give security for the reasonable expenses, including attorney's fees. \* \* \*" Wis. Stat. 1961 § 180.405(4).

This statute is sometimes in the opinion referred to as "the Wisconsin statute", without more precise description thereof.

<sup>4</sup> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . .

"(a) \* \* \* \*

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U. S. C. A. 78j(b).

the only relief which it had jurisdiction to grant under Section 14(a)<sup>5</sup> of the Act was a declaratory judgment as to the validity or invalidity of the proxies involved in the suit, and that, insofar as count 2 prayed relief other than such a declaratory judgment, that count also stated a derivative cause of action under Wisconsin law, which was subject to the provisions of the Wisconsin security for expense statute. Accordingly, the court ordered plaintiff to furnish a bond in the amount of \$75,000.00, conditioned for the payment of expenses to be incurred by the defendants in defending the suit. Upon plaintiff's refusal to provide security in accordance with that order, the court ordered that count 1 of the complaint be dismissed and that count 2 thereof likewise be dismissed, except to the extent that that count might be construed as a suit under Section 14(a) for a declaratory judgment as to the validity of the proxies solicited for the Case-ATC merger. This interlocutory appeal was then taken pursuant to the provisions of 28 U. S. C. A. 1292(b) and the order of this court, entered October 24, 1962, granting to plaintiff leave to appeal.

Three issues are presented on this appeal. First, did the court below err in its conclusion that the cause of action stated in count 1 of the complaint was derivative in nature and therefore subject to the provisions of Wisconsin security for expense statute? Second, did the court below err

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<sup>5</sup>"(a) It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of any national securities exchange or otherwise to solicit or permit the use of his name to solicit any proxy or consent or authorization in respect of any security \* \* \* registered on any national securities exchange in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U. S. C. A. 78n(a).



in its holding that the Wisconsin statute applies to count 2 of the complaint insofar as that count sought retrospective relief? Third, did the court below err in holding that count 2 of the complaint did not state a cause of action under Section 10(b) of the Securities Act?

With respect to count 1 of the complaint, the only issue before us for decision is the question whether the court correctly held the provisions of the Wisconsin statute applicable to plaintiff's cause of action. As the court recognized in its opinion, that issue depends upon a determination whether the allegations of the complaint state a derivative cause of action brought on behalf of the corporation, or a primary cause of action to redress an injury to plaintiff as a Case stockholder. If the cause of action stated is derivative, then the statute was properly applied. If it is not derivative, but is a primary right in the plaintiff, the statute has no application.

Plaintiff's first amended and supplemental complaint asserted a derivative cause of action on behalf of the corporation. After the court ruled that the Wisconsin statute applied to the case and ordered plaintiff to furnish bond in the amount of \$75,000.00, plaintiff amended his complaint in an attempt to allege the denial of his preemptive right to participate in the issuance of Case shares and an injury to himself, individually, as a shareholder of Case. He supported that allegation by the reallegation of essentially the same material facts which were alleged in the first amended complaint.<sup>6</sup>

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<sup>6</sup> Plaintiff filed this suit as a class action on behalf of himself and all other Case shareholders who are similarly situated. For convenience in this opinion, however, the singular "plaintiff" is used, with no reference being made to the class which he purports to represent, except where the context otherwise requires.



In holding the Wisconsin statute applicable to count 1 of the third amended complaint, the court below said, in part:

"After reviewing the allegations of count 1, it is clear to us that the plaintiff still complains of fraud and self-dealing, failure of directors to perform their fiduciary duties, etc., as in the first amended and supplemental complaint, and seeks redress for the alleged wrong in behalf of the corporation. He does not allege any wrong to himself different from that suffered by other stockholders, nor limit the relief sought to damages sustained by reason of loss of pre-emptive rights. He is concerned in our opinion not with the fact that stock was issued to others without being first offered to Case stockholders but with the fact that stock was issued for an allegedly insufficient consideration. We therefore hold that § 180.405(4) was applicable, that count 1 set forth a derivative cause of action and that the plaintiff must furnish security for reasonable expenses."

The principle that directors of a corporation owe a fiduciary duty to the corporation and the stockholders thereof, to deal honestly in corporate affairs is hornbook law requiring no citation of authority. As it affects the rights of shareholders, that duty has a two-fold aspect. Except where the right has been abolished by statute, or, where permissible, by provision in a corporate charter, the shareholders of a corporation have a preemptive right to participate ratably in the issuance of new shares of the corporation if they desire so to do. E.g., *Luther v. C. J. Luther Company*, 118 Wis. 112, 9 N. W. 69; *Spaulding v. North M. & T. S. Co.*, 106 Wis. 481, 494, 81 N. W. 1064; *Hammer v. Werner*, 239 App. Div. 38, 265 N. Y. S. 172. In addition to the preemptive right, the directors and officers of a corporation owe a fiduciary duty to not use their positions for their own personal advantage, or for the

advantages of others, to the detriment of the interests of the stockholders of the corporation. E.g., *Luther v. C. J. Luther Co.*, *supra*, 94 N. W. at 72; *Hammer v. Werner*, *supra*; *Schwab v. Schwab-Wilson Mach. Corp., Ltd.*, 13 Cal. App. 2d 1, 55 P. 2d 1268. A breach of the duty owed to the shareholders of a corporation in that respect gives rise to a cause of action by the shareholders in their own right. *Ibid.* Count 1 of this complaint must be measured in the light of those established legal principles.

We are indebted to Judge Tehan for the following summary of the allegations of count 1 of the complaint which, with slight embellishment, is taken verbatim from his memorandum.

Count 1 of the complaint alleges that plaintiff, the owner of 2,000 shares of Case common stock acquired prior to the merger complained of, sues in a representative capacity on behalf of himself and all other common stockholders prior to the merger except those participating in or cognizant of the wrongdoing alleged. In addition to Case, he joins as defendants certain of its directors and former directors, some of whom are also officers and former officers, and the executor of the estate of a deceased director. Defendants who are now directors of Case are sued individually and as directors, the defendant Rojzman is sued individually and as representative of American Tractor Corporation shareholders receiving Case stock as the result of the merger between Case and American Tractor Corporation, and the defendant Beeber is also sued, individually and as representative of holders of certain purchase warrants. In Count 1, the plaintiff alleges substantially as follows: In October 1956, Case formally announced to its shareholders a proposed plan of merger between Case and American Tractor Corporation and

proposed stock option amendments, which were purportedly approved by Case shareholders on November 15, 1956. The merger was purportedly consummated on January 10, 1957. Both the merger and stock option plan were effectuated by illegal and fraudulent acts and illegally deprived the plaintiff and other shareholders similarly situated of their preemptive right—rights which the plaintiff here seeks to enforce. Under the merger and plan, 648,852 shares of common stock and 1,197,704 shares of second preferred stock were set aside or issued without granting the plaintiff's class their pre-emptive rights to subscribe thereto.

The plaintiff then describes in some detail the acts which he believes to have resulted in a violation of the pre-emptive rights of Case shareholders as follows: In 1954, Elliott's company and a syndicate headed by him acquired 170,000 shares of American Tractor Corporation stock. Elliott violated the Securities Act of 1933 and regulations thereunder in connection with that stock and the sale of a portion thereof. Thereafter, the market price of American Tractor Corporation stock, most of which was held by Elliott, Rojzman and their associates, began an unreasonable rise, due to illegal manipulations, which manipulations Elliott was aware of prior to the merger. Rojzman, Brown, Grede and the Case management also knew prior to the merger that the market price of ATC stock was achieved illegally and artifiically. Since the merger one person has been found guilty in another district court of manipulating ATC stock from May, 1955 to February, 1956; and Alligan, Will and Company, formerly defendant in this cause and the specialist in ATC stock on the American Stock Exchange was found by the Securities and Exchange Commission to have engaged in improper and illegal activities while specialist with respect to ATC stock.

Case directors violated Wisconsin law and breached their fiduciary duties to the shareholders in approving the merger by including future earnings of American Tractor Corporation and future services of its officials as partial consideration for issuance of Case stock, by agreeing to issue Case stock at less than par value, by failing to evaluate properly the American Tractor Corporation assets acquired and paying an excessive price for American Tractor Corporation, by over-valuing American Tractor Corporation's and undervaluing Case's earnings and book value resulting in a fraud on Case shareholders, by relying on market price of American Tractor Corporation stock as a measure of American Tractor Corporation's value, by relying on American Tractor Corporation's own appraisal of its physical assets and failing to examine that appraisal, by considering future earnings as an element of value and by failing to recognize the necessity of future investments as part of the cost of the merger.

Case directors breached their fiduciary duties by approving and issuing a letter and proxy statement of October 15, 1966, prior to the meeting at which the merger was approved which contained numerous material omissions and false and misleading statements relied upon by Case shareholders in approving the merger and without which the merger would not have been approved. Three pages of the complaint are given over to instances thereof.

For example, it is alleged that defendants failed to disclose that the total purchase price of ATC exceeded \$17,000,000, that the book value of Case common stock was \$36.00 and ATC's only \$1.15, that persons who negotiated the merger were recipients of stock options; and that one of the director defendants, as a supplier, would receive a substantial increase in business as a result of the merger,

the merger was fair because in accordance with the comparative market prices of the two stocks, and the Case common shareholders would not be adversely affected when in fact their proportionate interest in the earnings, book value and voting power were seriously diluted.

Both the Case and American Tractor Corporation management groups were guilty of self dealing in connection with the plan and merger.

The conduct of the defendants, the plaintiff claims, constitutes actual or constructive fraud on himself and other shareholders similarly situated depriving them of their pre-emptive rights. He claims that if they had been permitted to purchase stock issued in the merger on the same basis as American Tractor Corporation shareholders, they could have obtained one-fourth share of common stock and one-half share of second preferred stock for \$2.20 for each share of Case common stock held by them at the time of the merger.

In Paragraph 19 of Count 1 of his complaint, the plaintiff alleges facts occurring after the merger particularly, that Brown, Grede, Rojzman and other principal defendants were no longer with Case and that Case was nearly bankrupt, in Paragraph 20 he alleges that the class he represents has been irreparably damaged by failure to recognize pre-emptive rights, and in his prayer for relief he asks that the court enter judgment in favor of the class he represents and against Case directors who approved the merger and all defendants the court finds responsible for the merger and the consequent deprivation of pre-emptive rights in an amount to be determined and/or that the court enter a decree directing Case to issue to the class he represents such securities of Case as the court deems necessary to compensate the class for violation of pre-emptive rights, and asks for such other relief as equity shall require.



Judge Tehan was correct in his conclusion that the facts alleged in count 1 are basically consistent with the statement of a derivative cause of action to redress a wrong to the corporation, but that conclusion does not resolve the issue which is before us. Those same facts may also state a primary cause of action by a stockholder for relief from injury to himself resulting from unlawful and fraudulent practice. *Hammer v. Werner*, 239 App. Div. 38, 256 N. Y. S. 172; *Schwab v. Schwab-Wilson Mach. Corp., Ltd.*, 13 Cal. App. 2d. 1, 55 P. 2d 1268; *Hagan v. Superior Court of Los Angeles County*, 2 Cal. Retr. 288, 348 P. 2d 896, 898.

In *Hagan*, for example, shareholders of a corporation intervened in a suit for dissolution of the corporation, alleging that the directors who had filed the suit for dissolution refused to recognize them as shareholders of the corporation, and that some of the directors had been parties to a scheme to fraudulently divert funds from the corporation to the detriment of the rights of the shareholders. The trial court ordered the plaintiffs to provide security for costs of the suit pursuant to the provisions of the California Corporation Code. The shareholders then filed a prohibition suit in the California Supreme Court alleging that the trial court had threatened them with contempt if they sought to take any further action in the dissolution suit without first complying with the order to provide security for costs. In granting the writ of prohibition, the court held, 348 P. 2d at 898, that the security statute did not apply to the intervening shareholders who were seeking to vindicate their own rights, even though their complaint in intervention alleged facts which would also give rise to a cause of action by the corporation.

We think the trial court failed to recognize the principle that the same allegations of fact might support either a derivative suit or an individual cause of action by share-



holders. We think count 1 of the complaint adequately states a cause of action for the redress of rights individual to the Case stockholders.<sup>7</sup>

Defendant's contentions that plaintiff is affected by the circumstances alleged in the same way as all stockholders of Case are affected, and that his suit is therefore, derivative, fails to take into account the realities of the circumstances alleged and the clear indication to the contrary of the Wisconsin decisions. If the allegations of the complaint are true, as we must assume them to be for present purposes, two separate categories of Case shareholders must be recognized, namely, those shareholders who participated in the practices alleged and benefited by the merger and related agreements and those shareholders who were not participants, with the result, as it is alleged, that their proportionate interest in the corporation was diluted. The former are expressly excluded from the class which plaintiff purports to represent. In this respect, this complaint cannot be distinguished from the complaint in *Luther v. C. J. Luther Co.*, *supra*, in which a part of the shareholders were aligned as plaintiffs against others as defendants.<sup>8</sup>

One further contention of the defendants must be noted. They argue, citing *Dousman v. The Wisconsin & L. S. M. & S. Co.*, 40 Wis. 418, 422, that an individual cause of action

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<sup>7</sup> Our conclusion is based upon the impression of the complaint as a whole, and it should not be construed as precluding the possibility that count 1 might contain specific allegations which are consistent with a derivative cause, only, and which are subject to being stricken as surplusage.

<sup>8</sup> Closely related to that contention is the defendants' argument that a class suit will not lie for the redress of shareholders' rights. However, that argument does not affect the merit of the complaint as stating a primary cause of action, and we express no opinion as to the validity of the argument. If the argument is valid, it may be presented to the court below upon a proper motion directed against the complaint.

to redress a violation of the rights of shareholders must be brought against the corporation alone. That position is not valid. In most of the cases in which courts have taken jurisdiction to vindicate the rights of shareholders, the suit has been against the corporation involved and its directors or other persons alleged to have been responsible for the injury. E.g., *Luther v. C. J. Luther Co.*, *supra*; *Hammer v. Werner*, *supra*; *Schwab v. Schwab-Wilson Mach. Corp., Ltd.*, *supra*. A director of a corporation acts as a fiduciary not only to the corporation but also to the stockholders, and the essence of a cause of action by a stockholder, based upon allegations of fraudulent acts by a director, is not the fraud against the corporation, but the fraud of the director as it affects the stockholders. *Schwab v. Schwab-Wilson Mach Corp., Ltd.*, *supra*, 55 P. 2d at 1269. While *Dousman* does contain statements which tend to support defendants' argument, such statements must be read in the light of the fact that only the corporation was named as a defendant in that suit. Moreover, to the extent that *Dousman* is authority for the proposition that a suit by an individual stockholder lies only against the corporation, its weight as authority is certainly undermined, if not overruled, by the later decisions in *Luther* and other Wisconsin cases.

We hold that count 1 of the complaint does state a cause of action on behalf of the stockholders individually, and that the court erred in holding that the provisions of the Wisconsin statute are applicable thereto.

In considering the correctness of the court's decision as it relates to count 2 of the complaint,<sup>9</sup> an analysis of the court's opinion in the light of the procedural history of the case places the issues in perspective. The plaintiff's

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<sup>9</sup> We are aided in our consideration of this issue by an exhaustive brief filed by the Securities and Exchange Commission as *amicus curiae*.

original complaint and his first amended complaint were based upon allegations of violations of state law, federal jurisdiction being predicated upon diversity of citizenship. After the court had held that the Wisconsin statute applied to the cause of action, plaintiff obtained leave to file his second amended complaint alleging both a violation of state law and a violation of the Securities Exchange Act. That complaint set forth both of those alternative causes of action in a single count, alleging, insofar as the Securities Exchange Act was concerned, a violation of Section 14(a). On January 2, 1962, upon a hearing on defendants' motion to compel a bond for expenses under the Wisconsin statute, the court ordered that plaintiff file a third amended complaint stating, in separate counts, the alternative causes of action under state law and under Section 14(a). At the same time, the court asked the plaintiff to consider the application to his cause of action of the decision in *Dann v. Studebaker-Packard Corp.*, 6 Cir., 288 F. 2d 201.

Thereafter the third amended and supplemental complaint was filed. As the jurisdictional basis for count 2, plaintiff asserted diversity of citizenship between the parties, Section 27 of the Securities Exchange Act and Sections 1331 and 1337 of the Judicial Code. 28 U. S. C. A. 1331, 1337.

By reference, plaintiff realleged substantially all of the charging paragraphs contained in count 1 of the complaint. He alleged that the merger between Case and ATC was consummated early in 1957, following its approval by a vote of two-thirds of the outstanding common and preferred shares of Case at a special stockholders meeting held for that purpose. The count alleged that the proxy solicitation material issued by the defendants prior to that special meeting was false and misleading and its use constituted a violation of Section 14(a) of the Act and the SEC

Rules promulgated thereunder: 17 CFR 240.14a-3, 140.14a-9. The theory of the cause of action stated in that count was the contention that the Case-ATC merger and stock option agreements approved by the vote of proxies given by shareholders of Case in response to allegedly unlawful proxy solicitation material were void agreements under the provisions of Section 29(b) of the Act. 15 U. S. C. A. 78cc(b). Plaintiffs sought relief declaring that the proxy solicitation material was false and misleading, that the proxies solicited thereby were illegal and void, and that the merger and all agreements entered into pursuant thereto were void. He also prayed damages for injuries sustained by himself and all other stockholders similarly situated which grew out of violation of the Act, and such other and further relief as equity might require.

In ruling upon the defendants' motion for security and in holding that the Wisconsin statute applied in part to count 2 thereof, the court relied upon the decision in the *Dann* case. Thus the court held that federal jurisdiction in a civil action for violation of the provisions of Section 14(a) is limited to the granting of prospective relief, i.e., a declaration of the validity of the proxy solicitation material as the merits of the cause might require. The court further held that count 2, insofar as it alleged a cause of action for damages and relief other than a declaratory judgment of the invalidity of the proxy solicitation material, was a suit arising under state law to which the Wisconsin statute applied. Finally, the court held that the allegations of count 2 did not state a cause of action for violation of Section 10(b) of the Act.

We think the court correctly held that Section 10(b) of the Act has no application to the facts alleged in the complaint at bar. That section and Rule 10(b)-5, promulgated thereunder, 17 CFR 240.10b-5, prohibits the use of manipu-

lative and deceptive devices in connection with the purchase or sale of securities, and afford a basis for a civil remedy for damages and other relief to persons injured by the use of such practices. E.g., *Ellis v. Carter*, 9 Cir., 291 F. 2d 270; *Smith v. Bear*, 2 Cir., 237 F. 2d 79; *Hooper v. Mountain States Securities Corp.*, 5 Cir., 282 F. 2d 195; cert. denied, 365 U.S. 814. We need not consider whether misleading proxy material may, under any circumstances, constitute a manipulative and deceptive device within the prohibition of that Section, and we express no opinion upon that subject. We hold only that the facts alleged in this complaint directly invoke the provisions of Section 14(a), and that only sheer speculation can bring the provisions of 10(b) into play.<sup>10</sup>

<sup>10</sup> The second amended complaint alleged a violation of Section 14(a) only. After plaintiff was directed to file a third amended complaint stating his alternative causes of action in separate counts, and after plaintiff had been requested to consider the impact of the *Dann* decision upon his complaint, he filed his third amended complaint in which he alleged the violation of 10(b) as well as 14(a). We think it not unreasonable to infer, as Judge Tehan did, that 10(b) was alleged in an attempt to circumvent *Dann*.

It also appears that count 2 was muddled by the allegations of diversity of citizenship for the same purpose. In the reasoning of the *Dann* opinion leading to the conclusion that there was no jurisdiction to award the relief prayed upon the merits of the complaint, the court observed that there was no allegation of diversity of citizenship to support jurisdiction over what the court construed to be a cause arising under state law. Plaintiff argues, or implies, that the court predicated its decision that there was no federal jurisdiction upon the lack of diversity allegations. He seeks to distinguish *Dann* from this complaint upon that basis. His analysis of *Dann* is false in that regard. The court had held that there was no jurisdiction under Section 27 of the Securities Exchange Act, and no cause of action arising under a statute of the United States. Its discussion of diversity was directed to a determination whether the allegations of the complaint would sustain federal jurisdiction to decide questions of state law. If there be jurisdiction under Section 27, that jurisdiction is neither enlarged nor diminished by the existence, or non-existence, of diversity of citizenship.

The diversity allegations of count 2 are wholly surplusage.



The critical issue with respect to the decision below as it relates to count 2 is the question whether the trial court correctly held that federal jurisdiction in a civil cause of action for enforcement of the provisions of Section 14(a) is limited to declaratory relief. Since the court below relied in its decision on the *Dann* case, we approach that issue from an analysis of *Dann*.

The complaint in *Dann*, filed by a stockholder of Studebaker, alleged the waste and dissipation of Studebaker assets growing out of a fraud upon the shareholders of Studebaker, which allegedly resulted from the use of false and misleading proxy solicitation materials. The complaint predicated jurisdiction upon the provisions of Section 27 of the Act and Section 1331 of the Judicial Code. The complaint prayed that the court declare void proxies solicited in violation of the provisions of Section 14(a), and, in the event that the court found that such void proxies had controlled the vote of Studebaker stockholders approving the arrangement between Studebaker and Curtiss-Wright Corporation of which complaint was made, that the court would, by its decree, restore Studebaker to its economic condition which had obtained prior to consummation of the arrangement with Curtiss.

The trial court dismissed the complaint. The Court of Appeals reversed, holding that a cause of action was stated under Section 14(a). Thus the court held that a civil suit by a shareholder will lie to enforce the provisions of that section. The court, however, having determined that a federal cause of action was stated by the complaint, then addressed itself to the question whether it had jurisdiction to grant the relief sought in the complaint. 288 F. 2d at 210-215. In reliance upon language contained in the opinion in *Gully v. First National Bank*, 299 U.S. 109, 117-118, the court concluded that federal jurisdiction under Section 14(a) is limited to declaratory relief related to the

validity or invalidity of proxies obtained in violation of the Act. Thus the court said, 288 F. 2d at 214:

" \* \* \* In reaching this decision, we are deciding that federal jurisdiction must end with the holding of a contested proxy election, that the right created by Section 14(a) of the Exchange Act is only broad enough to permit consideration of the *validity* of the proxies solicited in violation thereof, but it is not broad enough to permit the federal courts to determine the consequent *effects* of the validity or invalidity of said proxies."

Finally, the court held that the right to damages and other retrospective relief arising out of a violation of 14(a) is a question of state law, because such a remedy requires the interpretation and application of state, as well as federal law.

We respectfully disagree with the decision in *Dann* for two reasons. First, the court failed to note a critical distinction between the jurisdictional facts of *Gully* and *Dann*, namely, that a federal statute was involved only collaterally in the former, whereas the whole right of action in the latter was derived from a federal statute.

*Gully* was a suit by a state to collect local taxes levied against a national bank. The only ground upon which federal jurisdiction could be claimed was the fact that the bank had been chartered under an Act of Congress. Upon that factual background, the court held that the case arose under state law, uninfluenced by the fact that a federal statute had a collateral bearing thereon.<sup>11</sup>

By contrast, in *Dann* the complaint alleged a direct violation of a federal statute. Thus the controversy is a basic one requiring the interpretation and application of a federal statute. The rationale of *Gully* has no bearing upon the jurisdictional question.

<sup>11</sup> See also, *Chicago & N. W. Ry. Co. v. Toledo, P. & W. R. Co.*, S.D. Ill., ..... F. Supp. ....

Second, in our opinion, the court in its reasoning failed to distinguish between the question of jurisdiction and the question upon the merits of the case whether the plaintiffs were entitled to the relief which they sought. See, concurring opinion, Miller, C. J. 288 F. 2d at 217, 218.

Section 14(a) prohibits the solicitation of proxies of securities listed on a national exchange in violation of SEC Rules promulgated thereunder. Rule 14a-9 prohibits the use of false and misleading statements with respect to any material fact or the omission of material facts which would render any statement contained in a proxy solicitation false or misleading. 17 CFR 240.14a-9.

Section 27 of the Act vests exclusive jurisdiction in the United States District Courts over violations of the Act or SEC Rules and over all suits in equity or actions at law brought to enforce any liability or duty created by the Act or SEC Rules.

The obvious purpose of Section 14(a) is the protection of the right of shareholders to a full and fair disclosure of all material facts which affect corporate elections by proxy. *Dann v. Studebaker-Packard Corp.*, *supra*, at 208. See also *SEC v. Transamerica Corp.*, 3 Cir., 163 F. 2d 511, 518, cert. denied 332 U.S. 847. For the achievement of that purpose, the jurisdiction conferred by Section 27 must be broad enough to effectively protect that right. Thus, it is said in *Bell v. Hood*, 327 U.S. 678, 684, that federal courts have the power, under a general grant of jurisdiction to enforce a federal statute, to grant all of the relief which may be commensurate with the effective enforcement of the statute and the protection of rights created thereby, notwithstanding the failure of the statute to specify the remedies which may be employed.

Indeed, Section 27 has many times been so construed in cases arising under Section 10(b), the courts holding

that the jurisdictional grant includes the power to award damages and other retrospective relief. E.g., *Ellis v. Carter*, 9 Cir., 291 F. 2d 276; *Hooper v. Mountain States Securities Corp.*, 5 Cir., 282 F. 2d 195, cert. denied 365 U.S. 814; *Smith v. Bear*, 2 Cir., 237 F. 2d 79; *Fischman v. Raytheon Mfg. Co.*, 2 Cir., 188 F. 2d 783; *Kohler v. Kohler Co.*, E.D. Wis., 208 F. Supp. 808, 820. In at least two cases decided prior to *Dann*, the courts assumed the existence of power under Section 27 to award retrospective relief by whatever remedy might be necessary in a particular case to protect the rights created under Section 14(a). *SEC v. Transamerica Corp.*, 3 Cir., 163 F. 2d 511, 518, cert. denied, 332 U.S. 847; *Mack v. Mishkin*, S.D.N.Y., 172 F. Supp. 885, 889. *Contra*, *Howard v. Furst*, S.D.N.Y., 142 F. Supp. 507, aff'd on other grounds, 2 Cir., 238 F. 2d 790, cert. denied 353 U.S. 937.

In *Deckert v. Independence Shares Corp.*, 311 U.S. 282, the Court, applying the provisions of the Securities Act of 1933, which were similar to the provisions of Section 27, held that purchasers of securities sold in violation of the Act had a civil cause of action, not only against the vendor of the securities and other persons specified in Section 12(a) of the Act, but also against a third person having assets of the vendor in its possession. The court said, in part, 311 U.S. at 288:

"The power to enforce implies the power to make effective the right of recovery afforded by the Act. And the power to make the right of recovery effective implies the power to utilize any of the procedures or actions normally available to the litigant according to the exigencies of the particular case \* \* \*."

In other cases the courts have held a general grant of jurisdiction to the district courts to enforce a federal statute effective to authorize the appointment of a receiver in a suit for violation of the Investment Company Act of

1940,<sup>12</sup> *Aldred Investment Trust v. SEC*, 1 Cir., 151 F. 2d 254, 261, cert. denied 326 U.S. 795, a decree of restitution of rents collected in excess of the maximum rents permissible under the Emergency Price Control Act of 1942,<sup>13</sup> *Porter v. Warner Holding Company*, 328 U.S. 395, a decree of restitution for loss of wages resulting from a violation of the Fair Labor Standards Act of 1938,<sup>14</sup> *Mitchell v. Robert DeMario Jewelry, Inc.*, 361 U.S. 288, 291, and a decree of divestiture of property held in violation of Sections 1 and 2 of the Sherman Act.<sup>15</sup> *Schine Chain-Theatres, Inc. v. United States*, 334 U.S. 110.

We think the same principle must be applied in determining the scope of federal jurisdiction for the protection of rights created by Section 14(a). We hold that the court below has jurisdiction under Section 27 to award damages or such other retrospective relief to the plaintiff as the merits of the controversy may require.

The court below erred in holding the Wisconsin statute applicable to count 2. *McClure v. Borne Chemical Co.*, 3 Cir., 292 F. 2d 824, cert. denied 368 U.S. 939; *Fielding v. Allen*, 2 Cir., 181 F. 2d 163, cert. denied, *sub nom Ogden Corp. v. Fielding*, 340 U.S. 817.

The order dismissing plaintiff's third amended complaint is reversed, and the cause is remanded to the court below for further proceedings consistent with this opinion.

A true Copy:

Teste:

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Clerk of the United States Court of  
Appeals for the Seventh Circuit.

<sup>12</sup> 15 U. S. C. A. 80a-35.

<sup>13</sup> 50 App. U. S. C. A. 925(a).

<sup>14</sup> 29 U. S. C. A. 215(a), 217.

<sup>15</sup> 15 U. S. C. A. 1, 2.



**SECURITIES EXCHANGE ACT OF 1934****Sec. 14(a)**

It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of any national securities exchange or otherwise to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect to any security (other than an exempted security) registered on any national securities exchange in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

**Sec. 27**

The district courts of the United States, the Supreme Court of the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this title or rules and regulations thereunder, or to enjoin any violation of such title or rules and regulations, may be brought in any such district, or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so

rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 225 and 347). No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts.

### Sec. 29(b)

Every contract made in violation of any provision of this title or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this title or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule or regulation: *Provided*, (A) That no contract shall be void by reason of this subsection because of any violation of any rule or regulation prescribed pursuant to paragraph (2) or (3) of subsection (c) of section 15 of this title, and (B) that no contract shall be deemed to be void by reason of this subsection in any action maintained in reliance upon this subsection, by any person to or for whom any broker or dealer sells, or from or for whom any broker or dealer purchases, a security, in violation of any rule or regulation prescribed pursuant to paragraph (1) of subsection (c) of section 15 of this title, unless such action is brought within one year after the discovery that such sale or purchase involves such violation and within 3 years after such violation.

**Rule X-10B-5**

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

- (1) to employ any device, scheme, or artifice to defraud,
- (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection, with the purchase or sale of any security.

**INFORMATION TO BE FURNISHED SECURITY HOLDERS****Rule X-14A-3**

(a) No solicitation subject to this regulation shall be made unless each person solicited is concurrently furnished or has previously been furnished with a written proxy statement containing the information specified in Schedule 14A.

(b) If the solicitation is made on behalf of the management of the issuer and relates to an annual meeting of security holders at which directors are to be elected, each proxy statement furnished pursuant to paragraph (a) shall be accompanied or preceded by an annual report to such security holders containing such financial statements for the last fiscal year as will, in the opinion of the management, adequately reflect the financial position and operations of the issuer. Such annual report, including financial statements, may be in any form deemed suitable

by the management. This paragraph shall not apply, however, to solicitations made on behalf of the management before the financial statements are available if solicitation is being made at the time in opposition to the management and if the management's proxy statement includes an undertaking in bold-face type to furnish such annual report to all persons being solicited, at least twenty days before the date of the meeting.

(c). Four copies of each annual report sent to security holders pursuant to this rule shall be mailed to the Commission, solely for its information, not later than the date on which such report is first sent or given to security holders or the date on which preliminary copies of solicitation material are filed with the Commission pursuant to Rule X-14A-6(a), whichever date is later. The annual report is not deemed to be "soliciting material" or to be "filed" with the Commission or otherwise subject to this regulation or to the liabilities of Section 18 of the Act, except to the extent, that the issuer specifically requests that it be treated as a part of the proxy soliciting material or incorporates it in the proxy statement by reference. *(As amended by Release No. 4979, effective as to any solicitation of proxies commenced on or after February 6, 1954.)*

#### **Rule X-14A-9**

No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting, or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or

necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

Note: The following are some examples of what, depending upon particular facts and circumstances, may be misleading within the meaning of this rule:

(a) Predictions as to specific future market values, earnings, or dividends.

(b) Material which directly or indirectly impugns character, integrity or personal reputation, or directly or indirectly makes charges concerning improper, illegal or immoral conduct or associations, without factual foundation.

(c) Failure to so identify a proxy statement, form of proxy and other soliciting material as to clearly distinguish it from the soliciting material of any other person or persons soliciting for the same meeting or subject matter.

(d) Claims made prior to a meeting regarding the results of a solicitation.



*Lapchak v. Barium Steel Corporation, et al.*

United States District Court for the Southern District of New York. Civ. No. 91-356. July 20, 1955. Opinion of the court reproduced in full text.

## [OPINION OF THE COURT]

DIMOCK, D. J.: Defendant Barium Steel Corporation moves for an order or judgment pursuant to Rule 12(b)(6), F. R. C. P., dismissing the amended complaint upon the ground that it fails to state a claim upon which relief can be granted, and, pursuant to Rules 12(b)(1) and (2), F. R. C. P., upon the grounds that this court has no jurisdiction over its person or over the subject matter. In the alternative defendant Barium seeks an order directing plaintiff to provide security for costs.

Defendant Nelson Gammans too moves for an order or judgment dismissing the amended complaint upon the same grounds presented by defendant Barium and upon the additional ground that plaintiffs' claim is barred by various statutes of limitation and by plaintiffs' laches. This defendant also moves in the alternative for an order directing plaintiffs to provide security for costs.

The action is a derivative stockholders' action brought to recover for the corporation, Barium, damages alleged to have been suffered by Barium and profits alleged to have been realized by the individual defendants as a result of an issue of shares of Barium's stock for an inadequate consideration. Defendants are all alleged to have been officers and directors of Barium during the relevant period of time.

I am convinced that this court has no jurisdiction over the subject matter of this action. Therefore, I discuss only that issue.

The allegations of the amended complaint may be summarized as follows: In or before November 1945 the stockholders of Republic Industries, Inc. conceived "the common plan of foisting their shares on Barium in return for a block of Barium stock of vastly greater value." It was necessary in order that this plan could be carried out that there be effected an increase in Barium's capital stock. The defendant directors of Barium concurred in this plan because they were to share in the resulting profits and the new Barium stock was to be used to cement their control of Barium. A stockholders' meeting was called by Barium for the purpose of voting to increase the number of shares authorized to be issued and in connection with this meeting proxies were solicited. The proxy statements were false and fraudulent under section 14(a) of the Securities and Exchange Act of 1934, 15 U. S. C. § 78n(a), and Rule X-14A-9 of the Securities and Exchange Commission. At the meeting a majority of the stock voted that the authorized shares of Barium be increased from 1,000,000 to 2,500,000 shares. Had no proxies been given there would not have been a quorum at that meeting. Thereafter the exchange plan was carried out and as a result Barium sustained a loss and the individual defendants realized large profits at the expense of Barium. Plaintiffs' sole reliance for federal jurisdiction is placed upon section 27 of the Securities Exchange Act of 1934, 15 U. S. C. § 78aa which provides in material part:

"The district courts of the United States . . . shall have exclusive jurisdiction . . . of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. . . ."

Let it be assumed that section 14(a) of the Securities and Exchange Act of 1934 creates a civil right of action in behalf of a corporation against violating directors and

officers. Plaintiffs concede that the directors and officers would not be liable as insurers. If this amended complaint stated a claim for damages arising out of a violation of section 14(a) the presence of federal jurisdiction would be clear and the fact that the allegations of the amended complaint also constituted a state created claim would not defeat this jurisdiction. *Bell v. Hood*, 327 U.S. 678. But since plaintiffs concede the absence of insurer liability, the claim, to arise under the Act, must have a causal connection with the alleged violation. Plaintiffs say that it does. They say that it was through the offending proxy statements that proxies were obtained, through use of the proxies that additional shares were authorized, through issuance of additional shares that the exchange was effected and through the exchange that Barium was injured. I cannot agree that this connection is sufficient to support federal jurisdiction.

Even plaintiffs concede that if the proxy statement were followed by a fair exchange the directors would not be liable to the corporation. Also, it is clear that, had the proxy statement been perfectly lawful but followed by an unfair exchange, the directors would be liable for damage sustained and profits realized in violation of their fiduciary duties.

The common plan, as plaintiffs allege it, was to foist a less valuable block of stock of Republic upon Barium in exchange for a more valuable block of stock of Barium. The increased authorization and related false proxy statements were merely incidental to the plan. Since the liability asserted by plaintiffs may be proved without regard to the proxy statements and cannot be proved without regard to the alleged breach of fiduciary duty it is impossible to say that plaintiffs are asserting a right under or created

by a federal law. The allegations as to the proxy statements are either mere surplusage or a mere pretext for assertion of federal jurisdiction. Compare *Gully v. First Nat. Bank*, 299 U.S. 109; *Meyer v. Kansas City Southern Ry. Co.*, 2 Cir., 84 F. 2d 411, cert. denied, 299 U.S. 607, and *Nelson v. Leighton*, D.C.N.D.N.Y., 82 F. Supp. 661 with *Bell v. Hood*, 327 U.S. 678; *Fielding v. Allen*, 2 Cir., 181 F. 2d 163, cert. denied 340 U.S. 817 and *Stella v. Kaiser*, D.C.S.D.N.Y., 82 F. Supp. 301.

The motions to dismiss are granted on the ground of lack of federal jurisdiction.